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FM AMEMBASSY ASHGABAT

TO RUEHC/SECSTATE WASHDC PRIORITY 1289

INFO RUCNCLS/ALL SOUTH AND CENTRAL ASIA COLLECTIVE PRIORITY

RUCNCIS/CIS COLLECTIVE PRIORITY

RUCNMEM/EU MEMBER STATES COLLECTIVE PRIORITY

RUEHAK/AMEMBASSY ANKARA PRIORITY 4124

RUEHBJ/AMEMBASSY BEIJING PRIORITY 1938

RUEHKO/AMEMBASSY TOKYO PRIORITY 1803

RUEHIT/AMCONSUL ISTANBUL PRIORITY 2372

RUCNDT/USMISSION USUN NEW YORK PRIORITY 0844

RHMFIS/CDR USCENTCOM MACDILL AFB FL PRIORITY

RUEHVEN/USMISSION USOSCE PRIORITY 2750

RUEAAIA/CIA WASHDC PRIORITY

RHEFDIA/DIA WASHDC PRIORITY

RHEHNSC/NSC WASHDC PRIORITY

RUEKJCS/SECDEF WASHDC PRIORITY

RUEKJCS/JOINT STAFF WASHDC PRIORITY

C O N F I D E N T I A L SECTION 01 OF 02 ASHGABAT 001016

SIPDIS

STATE FOR SCA/CEN; EEB

E.O. 12958: DECL: 08/05/2018

TAGS: PGOV ECON EFIN TX

SUBJECT: TURKMENISTAN: CURRENCY REFORM A NET POSITIVE
DESPITE WORRIES OF IMPENDING HYPERINFLATION

REF: A. ASHGABAT 00213

¶B. ASHGABAT 00551

¶C. ASHGABAT 00765

Classified By: Charge Sylvia Reed Curran for reasons 1.4 (b,d).

¶1. (C) SUMMARY. In the first few months of relative stability since currency unification, prices remain high and locals struggle to adjust. The investment climate seems to have visibly improved, however, despite the continued lack of a stable financial framework to support entrepreneurs and private enterprises. The banking sector has been strongly affected, but ironically remains stable due to its inefficiency and lack of investment incentives. The greatest challenge will most likely come in 2009 as the implications of the currency redenomination project may create enough instability to cause hyperinflation. Yet on the whole, the currency unification should be viewed as a net positive and evidence of a government that is willing to modernize the economy. END SUMMARY.

WHERE MARKET PRINCIPLES DARE NOT DWELL

¶2. (C) Approximately 90 days have passed since the Central Bank of Turkmenistan announced a unified exchange rate of 14,250 manat per \$1 on May 1 (Ref A). Normally, when a country reevaluates its currency, the price of imported goods should decrease. However, in Turkmenistan this has largely not happened. Rather than letting market principles dictate price, the threat of further devaluations and fluctuations, coupled with the almost 800% increase in gas prices (Ref B), keeps costs high (NOTE: There is some indication, however, of an adjustment) several imported food items and domestic products such as shampoo have seen a noticeable price decrease in the past month. END NOTE.).

¶3. (C) Western analysts have praised the currency unification as a step towards greater transparency and fairness in Turkmenistan's business climate. Still, one analyst lamented the lack of new foreign investment being pumped into the country; he cited the lack of new contracts, oil fields opening, tenders on cellphones, etc. Similarly, he pointed to a still significant ruble-manat arbitrage, despite a limit on dollar holdings for foreign companies.

Worse, despite talk of reforms, there is not much of a legal financial framework to support entrepreneurs or Small-Medium Enterprises (SME,s). As EU TACIS,s Michael Wilson pointed out, all export and import remains stubbornly under state control, as does commodity exchange and licensing and registration.

EVERYTHING IS POSSIBLE NOW?

¶4. (C) EBRD,s Neil McKain is more optimistic about the effect the currency unification has had. Despite the cost to the local population, there have been benefits from the simplified banking practices. Trade is streamlined, and it is no longer as necessary to keep track of how much companies are allowed to earn in foreign currency. The EBRD has begun financing several SME credit lines to local banks and has begun to directly invest in private enterprises such as breweries and ice-cream parlors.

THE BANKING SECTOR) UNPROFITABLE BUT STABLE

¶5. (C) The most critically affected sector affected is banking. Because the minimal capital requirement for Turkmenistan banks is \$5 million, at least five banks currently no longer meet this requirement, due to devaluation and currency speculation. Still, banks remain stable because of a peculiarly low loan:asset ratio (NOTE: Turkmenistan's banks keep 20% in loans and the rest in deposits, treasury notes, stocks, bonds, etc. Normally, banks keep 80% in loans). The unofficial 15% cap on the interest rate means

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there is no incentive to lend) banks are stable but inefficient at making money.

EARLY 2009) POTENTIAL DISASTER?

¶6. (C) The real question is whether or not Turkmenistan,s economy will be able to handle the impact of early next year. The currency redenomination project scheduled for early next year will probably contribute to inflation as retailers attempt to capitalize on the change. Neil McKain told EmbOff that rather than a 1000 old manat = 1 new manat change, redenomination may be conducted as 4000 = 1. This might result in further inflation due to psychological costs associated with readjustment.

FLOAT OR SINK? IMPLICATIONS OF A FIXED EXCHANGE RATE

¶7. (C) There has been some discussion as to the possibility of transitioning from a fixed exchange rate. Most agree that Turkmenistan lacks the human capacity for a free-floating rate. One analyst speculated that the real exchange value could go up to 20k-30k TMM per 1\$ if the manat were allowed to float. A May 21 annual EBRD meeting discussed the possibility of a currency board arrangement, not unlike that of Eastern Europe. Intriguingly, a junior director of the Central Bank, Berdiyev, remarked at the meeting that &the market will eventually decide the xchange rate."

¶8. (C) COMMENT: On the whole, the currency unification should be viewed as a net positive. The breadth and ambition of the reform process is admirable and seems to signal a genuine desire for a modern economy, albeit one that is "Turkmen style." Government projections of inflation are more reasonable, and pensions and salaries have gone up by 10%, although this could be more as a response to grumblings that resulted from the dollar devaluation. The economic climate is visibly improving, but all eyes should be focused on the possible rough waters the government may have to navigate in early 2009. END COMMENT.

CURRAN